

Comments of Jan Smutny-Jones
Before The
Subcommittee on Energy Policy, Natural Resources
And Regulatory Affairs
Of The Committee on Government Reform
Concerning the Market Redesign Efforts of the
California Independent System Operator
April 8, 2003

Thank you Mr. Chairman and members of the Committee for the opportunity to testify on the market redesign efforts of the California Independent System Operator. I am Jan Smutny-Jones, the Executive Director of the Independent Energy Producers.¹ I previously served as Chair of the California Independent System Operator (CAISO) from Start-up through January 2001.

I would like to briefly discuss Market Redesign efforts made in California and some concerns I have that problems may arise again if we fail to learn our lessons from the past.

California is on the road to recovery. Several initiatives are underway contributing to stability in California's energy market, but unresolved issues and political rhetoric continue to hamper progress. We must learn from our past mistakes, rely upon experts and proven markets elsewhere and move forward. Now is not the time to reinvent the wheel.

You have addressed a series of critical issues in your questions submitted to the panelists and I would like to briefly review some solutions that will continue the road of recovery. (IEP has also submitted written testimony responding to the questions raised by the Committee²)

I hope your will take away an understanding of the following overall issues that need to be addressed going forward:

¹ IEP is California's oldest nonprofit trade association representing the interests of electric generators in California. IEP's members collectively own and operate more than 20,000 MW of installed generating capacity participating in California's competitive markets, and some are involved with new project developments that will operate within the competitive markets. Other members, consisting of consultants and law firms, provide support services for the industry.

² IEP's testimony can be accessed at www.iepa.com or by calling (916) 448-9499

- **Stability**: A core cause of the energy crisis was an inadequate infrastructure. Infrastructure investments require regulatory and political stability. This can be provided by clearly articulated market rules, a redesigned market and coherent procurement process.
- **Resource Adequacy**: IEP member companies are in the resource adequacy business. We have added almost 10,000 MW of new generation over the last four years. These projects have included adding additional renewables, building new plants and the modernizing existing units. This is providing reliable, efficient and environmentally friendly energy to California customers. Establishing a Resource Adequacy Requirement (RAR) is a fundamental component of Electricity Market Design. A RAR will allow the CAISO and key energy agencies and municipalities, to accurately account for loads and resources in a forward looking, consistent, verifiable manner. This will help ensure that the specific RAR goals are consistent with the State's overall resource needs and the lights stay on.
- **Market Structure**: A workable market design based on sound economics and proven markets structures should be established as soon as possible. California's previous experiment with an unproven market structure was a disaster. There is no time to waste trying yet another experiment in order to appease certain interests. Critics of these proven markets need to come forward with solutions or alternatives. As Mark Twain put it: "Any fool can criticize, condemn and complain, most fools do".

The market structure in California should mirror proven markets elsewhere. We should not make modifications to satisfy certain sectors when experts warn of the dangers. For example: One utility is arguing it should be allowed to "opt out" of security constrained economic dispatch. Large utilities "opting out" would appear to undermine the concept of a comprehensive market redesign.

One of the most contentious issues surrounding market design in California is the implementation of Locational Marginal Pricing (LMP). Locational Marginal Pricing is a tool that identifies and quantifies transmission congestion at specific substations, which are also known as "nodes". This LMP tool allows for the efficient dispatch of the system and potentially provides incentives for infrastructure development or Demand Side Management (DSM). LMP is a foundation of the successful Eastern markets.

The efforts of the ISO to implement an LMP based market design have been met with significant political resistance from various market participants, specifically related to transmission right allocation and physical vs. financial congestion revenue rights (CRR). There are ways to address these concerns by implementing a model in a transitional manner and by allowing nodal load pockets to be aggregated and averaged through ratemaking. However, this load aggregation may only solve issues for those regulated by the CPUC.

It is critical that there is a transition to LMP implementation in California. The issues identified above do need to be resolved and the market will need to adjust to an LMP based market. A transition will also provide an opportunity to study real data determining the actual effects of LMP under real market conditions.

- **Establishment of a Stakeholder Advisory Committee:** A well functioning stakeholder process is the key to a successful market fostering open and honest communication between all market participants, including the CAISO and the Federal Energy Regulatory Commission. A meaningful stakeholder process can identify and resolve issues, or at a minimum, reduce the number of issues that require further litigation reducing costs for all participants, including the CAISO.

IEP, working in conjunction with other stakeholders, has developed a proposal establishing a Stakeholder Advisory Committee (SAC) similar to the structures found in other successful markets. This structure can and should be implemented immediately regardless of the CAISO corporate governance structure in place.

- **Seams Issues:** There are several critical seams issues that need to be addressed in the West. It is important that the market structures adopted by California, RTO West and West Connect be not just compatible but complementary. Clear consistent markets and rules across the entire West would have gone a long way to prevent many of the problems experienced during the crisis.

For example an independent West Wide Market Monitor should be established that evaluates the markets in the WECC over a broad geographic area and timeframe. This market monitor should be independent of the RTO's management and not subject to its direction. This Regional Market Monitor should report directly to the FERC's Office of Enforcement and the Board of the Regional Transmission Organization.

In conclusion, the energy crisis was a convergence of a serious supply and demand imbalance, poor market design and an inadequate regulatory response. It need not and should not be repeated. We need to encourage infrastructure investment providing new supply, implement meaningful market redesign and ensure that our regulatory institutions are reformed in a manner that responsive to modern market realities. It is time for action. We cannot afford another failure.

Thank you